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**Insurance** // North America Construction

## **Steering the Course: Stand-Alone Course of Construction (COC) Policy vs. COC Property Extension**

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- *A 50-unit condominium housing development under construction in Greater Boston has been destroyed by fire. Investigators are still working to determine the cause of the fire which began shortly before 3 a.m. The damage was estimated at \$20 million to \$30 million.*
- *A week before an 18-story apartment building under construction was to be occupied, a three-inch water pipe on the 18th floor failed. Water flowed overnight and for an undetermined period of time before drainage was noticed on the 5th floor. Damaged areas of the building included the elevators, cabinetry, drywall, ceiling fixtures, flooring and the fire alarm system.*
- *A five-alarm blaze drew hundreds of firefighters to a construction site near the University of Maryland and caused an estimated \$39 million in damage.*

All it takes is a spark. From a sander or errant cigarette. And POW! Igniting common, flammable construction materials like wood, solvents, packaging and gasoline and turning a work in progress to a pile of ash. It's a powerful blow to any construction firm and property owner.

As seen from the examples above, fire is the leading cause of loss during construction activities. According to an April 2017 report by the National Fire Protection Association (NFPA), each year between 2010 and 2014, municipal fire departments in the U.S. each year responded to an estimated average of 3,750 fires caused in structures under construction, 2,560 fires caused in structures undergoing major renovation, and 2,130 fires caused in structures being demolished. These fires resulted in \$172 million in direct property damage per year.

The second most frequent cause of loss during construction is water damage. According to Insurance Services Office (ISO) data, it also represents a higher than average percentage of claims, accounting for about 12.84% of all claims, with the average severity of a claim hovering around more than \$138,404.

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## Recovery Mode

When a construction company is in the midst of building something great, it's painful to see its sudden destruction and then have to muster up the wherewithal required to start all over again. It can be particularly painful if the ability to rebuild is hindered by finance issues or insurance disputes. These are exactly the times when a construction firm realizes the value, and the quality, of its Course of Construction (COC) insurance coverage. Course of Construction Insurance, also known as Builder's Risk insurance, insures buildings or projects under construction against the costs of repair or replacements in the event of an accident just like the ones mentioned above. It's designed to protect owners and contractors from the devastating impact of fires, floods, vandalism, theft, and other unwelcome accidents to a construction project.

COC provides both owners/developers and general contractors peace of mind. Owners are assured their contractors will have the funds to rebuild in the event of a loss, and contractors are assured they will have the costs available to start over in such an event.

Since Course of Construction insurance covers a number of parties, it can be obtained by the owner, contractor, engineer, or project manager. The party responsible for obtaining COC may be specified in the construction contract itself. The owner and/ or general contractor typically obtains the policy, and are covered as "named insureds" who are protected from paying for losses out of their own pockets.

## An Add-on

In today's market, COC coverage is widely available on a standalone basis but can also be incorporated as an extension to a property policy. When considering whether or not to rely on a COC property extension for a construction project or to buy standalone coverage, there are many factors to consider.

For one, consider that subcontractors are included on a COC policy as "additional insureds," receiving the same coverage benefits regardless of whether the policy was taken out by an owner or contractor. Both named and additional insureds on a COC policy are protected from legal suits if they happen to be the party responsible for the loss, as an insurer cannot bring action against someone covered by the same insurance policy. Typically a Property policy only insures the interest of the Named Insured, so what happens when the contractor and subcontractors have a direct exposure to a loss? Do you want to rely on the Owners goodwill or would you rather make sure you're covered properly under a specific COC policy?

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## Careful consideration

Some other critical factors to consider:

- A Property policy usually has an annual expiry date, so what happens when the policy is non-renewed or is placed with another carrier? Are they going to accept your project which might take 3 to 4 years to complete? The chances are very slim especially if the property policy is placed with a new insurance carrier who was unaware of any ongoing projects.
- There are many hold harmless agreements within a construction contract so can a contractor be absolutely certain these will be accepted by a property insurer especially when they're not specifically added as a Named Insured or Additional Insured? The whole premise of a Stand-alone COC policy is to insure every contractor on site and there is no chance of subrogation against any contractor, subcontractor or owner responsible for a loss. A property insurer might pay for a loss but the chances of them seeking legal action or subrogation to recover for their loss is very likely. And that could get ugly!
- A stand-alone COC policy recognizes additional costs which a property insurer might not consider. When a loss occurs and a re-build is required would a property carrier consider the additional labor costs to re-construct or would they simply pay for the physical damage without any consideration for the Contractors margin of profit? This scenario is not something any contractor would want to leave to chance.
- Many property policies cover multiple locations, so if the project is located in a Natural Peril zone (ie Flood and Earthquake) how do the aggregate limits apply? The property insurer would likely cover the specific locations insured under their policy and then if the limits haven't been eroded they would then pay for an unnamed project site. A stand-alone COC policy has dedicated Flood and Earthquake limits which will pay first dollar until eroded.
- A typical project site will have items brought onto site by the contractor such as hoarding, form works, office trailers, etc., so it begs the question whether a property carrier would consider these items as first party insured items or third party equipment which is not insured unless coverage is sought through a liability policy.

- A property policy would likely cover additional expenses incurred by the owner but what happens when the contractor has extra costs associated with a loss?
- An owner's property policy may carry very high deductibles, so if this isn't addressed in the construction contract then a contractor could be held to excessive deductibles which becomes a game of risk vs. reward (ie how much is the deductible vs. how much is the profit).
- A typical property policy contains a Boiler and Machinery exclusion which would void any Testing and Commissioning coverage which is a fairly standard extension under a stand-alone COC policy.
- One item an owner might want to consider under their own property policy is their willingness to expose their loss record to something, a loss, that is the responsibility of a contractor.

## Who's at the controls?

There are many factors to consider as a contractor when deciding to purchase standalone COC coverage or rely solely on an owner's COC property extension.

A stand-alone COC wording is designed specifically to cover all risk associated with a project and recognizes multiple parties are involved and should be covered accordingly. It is very tailored coverage whereas a COC property extension is an add-on, a quick, short-term solution – that certainly streamlines your insurance – but it also runs the risk of stirring up some complicated issues and disputes.

That's why more contractors manage their construction project risks with dedicated coverage, a standalone COC policy, choosing to steer their own course.

### Stand-Alone COC Policy vs. COC Property Extension (At a Glance)

	Stand-Alone COC	COC Property Extension
<b>Project Term</b>	Covers the project until final acceptance.	Annual Policy - must be renewed every year until the project is completed.
<b>Subrogation</b>	Hold harmless agreements in place for all parties associated with the project (ie. No Subrogation).	A typical property policy has rights of subrogation against the responsible party - could lead to a prolonged claims settlement.
<b>Margin of Profit</b>	Covers additional labor costs to re-build the project.	Property policy could be limited to direct damage without any consideration for the Contractor's Margin of Profit.
<b>Aggregated Limits</b>	Provides a dedicated Limit for all Natural Perils (ie Flood, Earthquake and Windstorm).	Natural Peril Aggregate Limits could be eroded if multiple locations are subject to a loss.
<b>Equipment on Site</b>	Covers all equipment at site which forms a part of the project.	Hard to say if a Property carrier would consider these first party insured items or third party equipment.
<b>Additional Expenses</b>	Covers all project participants additional expenses.	Coverage may be limited to the owners additional expenses.
<b>Deductibles</b>	Mutually agreed upon deductibles which factors in the Contractor's Margin of Profit.	Contractor could be held to an Owners excessive deductibles - becomes a game of Risk vs. Reward.
<b>Boiler &amp; Machinery Exclusion</b>	Testing and Commissioning is a standard extension under a COC policy.	Usually contains a B&M Exclusion which would eliminate the Testing and Commissioning coverage.
<b>Loss Record</b>	Losses attach to the specific project.	Losses attach to the owner's own property policy which could affect their renewal rating.

**To learn more about COC coverage, please contact your XL Catlin North America Construction Underwriter.**

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